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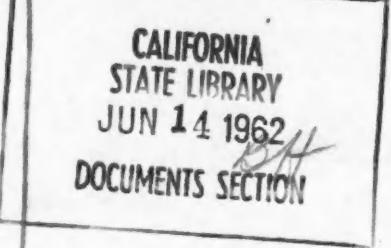
1959

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TRANSCRIPT OF PROCEEDINGS

HEARING ON
HOUSE RESOLUTION NO. 405^(by)

December 1, 1959
Los Angeles.



ASSEMBLY INTERIM COMMITTEE ON PUBLIC UTILITIES
AND CORPORATIONS. - SUBCOMMITTEE A

Rex M. Cunningham, Chairman

Carl A. Britschgi

Montivel A. Burke

Ronald Brooks Cameron

Charles Edward Chapel

Augustus F. Hawkins

Frank Luckel

Robert S. Thurn, Committee Consultant

Norma Waggershauser, Committee Secretary

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ASSEMBLY INTERIM COMMITTEE
ON
PUBLIC UTILITIES AND CORPORATIONS
SUBCOMMITTEE A

Rex M. Cunningham, Chairman

Hearing on House Resolution No. 405 on December 1, 1959 at 10:00 a.m.
in Room 115, State Building, Los Angeles, California

MEMBERS PRESENT:

Rex M. Cunningham
Carl A. Britschgi
Ronald Brooks Cameron
Charles Edward Chapel
Augustus F. Hawkins

MEMBERS ABSENT:

Montivel A. Burke
Frank Luckel

STAFF MEMBERS PRESENT:

Robert S. Thurn, Consultant
Norma Waggershauser, Secretary

OTHERS PRESENT AND HEARD:

Thomas D. Hodge, Los Angeles Better Business Bureau
Herbert A. Smith, Assistant Commissioner, Division of Corporations,
Department of Investment
John G. Sobieski, Commissioner of Corporations, Division of
Corporations, Department of Investment
Mrs. Frederick W. Spencer, California Federation of Women's Clubs
Mrs. Fred S. Teasley, State Radio and Television Chairman,
California Federation of Women's Clubs

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CHAIRMAN CUNNINGHAM: Ladies and gentlemen, this is a meeting of a subcommittee of the Assembly Interim Committee on Public Utilities and Corporations. The study of the subject matter on the sale of business franchises and similar business arrangements has been assigned to this interim committee by House Resolution No. 405, a copy of which is available from our Sergeant-at-Arms. House Resolution No. 405 was adopted at the 1959 Regular Session of the Legislature and directs that this interim committee make this study and report back to the 1961 Regular Session of the Legislature with legislation, if legislation is indicated, or a report that legislation is not needed and would not be beneficial in this regard.

At this hearing the committee hopes that the testimony will inform us as to the number of businesses that presently engage in any way in the purchase or sale of a business franchise, exclusive processes, patents or trade names. The committee feels that it is advisable to make a determination as to the number of businesses affected so that the committee will not advise any regulatory legislation to the Legislature that would unduly hinder the great number of legitimate businesses in the interests of correcting fraud or misrepresentation in those instances that would be statistically insignificant. This committee is well aware that many times legislation is requested and initiated in the interest of curing an evil which undoubtedly exists. However, the net effect is that people engaged in customary and legitimate businesses find themselves regulated unnecessarily and such regulations add to their cost of doing business.

It is the intention of this committee that no such regulatory legislation will result from our study. If the committee finds that

there is a field in this regard where fraud and misrepresentation exist and regulation is necessary, then recommended legislation must be drafted in such a way as not to interfere with customary and legitimate businesses.

With the above view in mind, this committee intends to hold a short hearing today in order to acquire for our record the number of businesses affected and the impact the sale of business franchises, exclusive processes, patents and trade names have on the economic business life of our state. We expect to receive testimony as to abuses of transactions in these fields. However, I hope the testimony relative to these abuses will concern a general pattern rather than isolated incidences as it is the general pattern of these abuses we must reach by possible legislation.

Our first witness today will be Mr. John G. Sobieski, Commissioner of Corporations for the State of California.

JOHN G. SOBIESKI, COMMISSIONER, DIVISION OF CORPORATIONS,
CALIFORNIA DEPARTMENT OF INVESTMENT: Mr. Chairman, on my right is Mr. Herbert Smith, Assistant Commissioner of Corporations, who is in charge of our Los Angeles Office. Our testimony will be very brief and Mr. Smith and I will be happy to answer any questions.

We believe that there is a clear line of distinction which can be made, and should be made, in the type of franchises that are under consideration. Where a franchise is sold for the purpose of promoting a new venture we have a distinct class of activities which does not impinge at all upon ordinary established businesses. We also have a class of activities where protection to the public is particularly needed. Where a business is already established and manufacturing a product the person who is invited to acquire a

franchise for that business has something tangible that he can base his judgment on but where a business is not established, and a person comes and says "I want to sell you a franchise in a business which I am going to establish", then the person is required to make practically the same type of judgment that he would make if he was asked to buy a share of stock in a company which is about to be established.

A person might be quite skilled in judging whether he could sell soda water or something of that sort and be utterly unskilled in judging whether a company that proposes to go into the manufacturing of soda water is properly capitalized and has the other factors that would enable it to succeed from a business point of view.

In the Division of Corporations we have noticed, in a certain number of cases, where people you might say have a choice as to how they are going to finance their new venture. They can finance it through the sale of stock or they can finance it through the sale of franchises and both of them are of a speculative nature.

I think the committee could well differentiate between what I would call a speculative franchise and a franchise for an established concern. Where a company seeks to promote itself by raising money from the public it seems to me that there is little economic distinction between launching the business through the sale of stock and launching the business through the sale of franchises. In fact, there could easily be greater danger to the public in launching the business through the sale of franchises because in that instance the purchaser, instead of concentrating on the financial problems of the new business, is liable to be thinking more of how much money he could make in distributing that product, whereas he is making an agreement with a company which has no established record

of performance and whether the company can get off the ground and become a success or not depends upon the same factors that have to be judged in any new company. That is, is it properly capitalized; are the men who are the the head of the company men of good business reputation and reasonably experienced to qualify them for carrying on that sort of arrangement; are the financial arrangements fair and reasonable, such as from a business point of view indicates that the business venture would be successful.

Therefore, I feel that there is a field where regulation of franchises would be in the public interest and likewise, would not impinge upon legitimate business and that is where a new venture is sought to be financed, not through the sale of stock, but through the sale of franchises.

I feel the Division of Corporations could administer such a law with a minimum of difficulty because the problems of analysis would be substantially the same, speaking now entirely with respect to financing a new venture, as the ones we have to make in analyzing applications for permit to sell stock in a new venture.

The fee schedule, which is already in effect, would provide, in our opinion and I have discussed this with the assistant commissioners, ample revenue to reimburse the cost to the Division of Corporations. We have not been able to estimate how much it would cost to administer it. We believe it would not be large and any additional cost would be covered by the additional fees which the Division of Corporations would collect. In other words, we could say that an application to sell franchises for a new venture, which is not established, would require a permit from the Division of Corporations the same as a permit that is required for the sale of stock and that would just about be it.

ASSEMBLYMAN CHAPEL: Commissioner, several years ago I introduced the first bill on this subject and we didn't try to push it because we didn't have the background for that type of legislation. However, you have indicated there is a necessity for clarifying legislation giving you more authority in cases where they are trying to finance a new venture by the sale of franchises. Is that correct?

COMMISSIONER SOBIESKI: That is correct, sir.

ASSEMBLYMAN CHAPEL: And you would welcome and support properly worded legislation emanating from this committee hearing on that subject. Is that correct?

COMMISSIONER SOBIESKI: That is correct, sir.

ASSEMBLYMAN CHAPEL: Now about six or eight years ago I introduced a bill along this line but, as I said, we did not have the background that we have now and the bill wasn't pushed for that reason. What caused me to do it, and I want to know if you have had any experience with this, was that there was a man selling franchises on how to be a loan shark. Now this sounds ludicrous but he sold one to a real estate broker in Inglewood who was an intelligent man, who had 30 or 40 salesmen in a well established place. He sold him a franchise for \$5,000 on how to be a loan shark. He gave him a franchise to loan money at exorbitant rates of interest but in addition to selling him the franchise, the man selling the franchise was to get a cut on every loan ever made, whether he helped make the loan or not. That franchise lasted about a year or two before I heard about it. It ran out and then they got a sucker in Westchester who bought it for I believe \$5,000 and they told him they only wanted one in the neighborhood. They meant they could only catch one in the neighborhood. Now has your office had any experience of this type?

COMMISSIONER SOBIESKI: Would you like to answer that, Mr. Smith?

HERBERT A. SMITH, ASSISTANT COMMISSIONER, DIVISION OF CORPORATIONS,

CALIFORNIA DEPARTMENT OF INVESTMENT: No, Mr. Chapel, I am not familiar with that particular type of franchise.

ASSEMBLYMAN CHAPEL: I asked the two real estate men concerned why they didn't complain. In fact, I wanted to get them down here and they said they were ashamed because if the publicity got into the newspapers they would look like such big fools that it would hurt their real estate business and yet they were taken.

MR. SMITH: I would think, from what you have said, that there might have been a violation of the Personal Property Broker's Law. Under those circumstances in which there is an agreement to divide the fees I doubt that anyone is licensed under the appropriate law from what you have said.

ASSEMBLYMAN CHAPEL: These were franchises to be a loan shark. It's really the strangest thing I have ever heard of. Now the second type of thing that I wanted to ask you about to see if you have had any experience on it is work at home. This, of course, may violate the federal postal regulations. They give you a franchise, especially to crippled and elderly women, assembling useless items and things like that. Have you had any experience on that?

MR. SMITH: We have not had any experience on that, Mr. Chapel. As a matter of fact, I doubt that a work at home project would be defined as a franchise. Generally, the gimmick is that a machine of some sort is sold to an individual upon the representation that if they produce a product, the seller of the machine will purchase the product. Of course the difficulty is that the person making

the product can never do it to the satisfaction of the seller of the machine so he is never able to sell the product but I don't think that is the type of transaction or franchise that is contemplated when we talk of franchising.

ASSEMBLYMAN CHAPEL: The third thing that I wanted to ask you is this: Do you remember when a bunch of charm and modeling courses folded up up north. In the field of charm and reducing where they sell these franchises to people, have you had any experience on that?

COMMISSIONER SOBIESKI: We have had some experience on that. I think there is a distinction between selling a franchise for the purpose of financing an operation and requiring that the franchise holder have a certain amount of capital so that he can properly handle the business. I think that our activity should be directed entirely to where the franchise is being sold for the purpose of financing an enterprise.

ASSEMBLYMAN CHAPEL: Now the fourth type of thing that I have heard complaints about is nursing and massaging schools. The sale of franchises to women to run a practical nursing school or massage parlor. Have you had experience on the sale of franchises, within the scope of this hearing, in this field?

COMMISSIONER SOBIESKI: We haven't gone into the massage parlors either. Frankly, those people don't complain to the Division of Corporations but I would like to mention that in the operation of the Tucker automobile, the Division of Corporations, under my predecessor, did a very fine job in preventing the sale of that stock in California but they got almost as much money from the public through the sale of franchises as they did through the sale of the stock and both of them were equally worthless.

ASSEMBLYMAN CHAPEL: Have you had experience with the sale of franchises to women who run these nursing schools?

COMMISSIONER SOBIESKI: We have heard about them but complaints have not been made to the Division of Corporations.

ASSEMBLYMAN CHAPEL: I asked these people once why they didn't complain to you and they said they were afraid it would get out in the newspapers and they would look like fools. They were ashamed of being suckers and I guess we should let them suffer if they won't complain, but this is the kind of junk I run into and they are afraid to sign an affidavit because they are afraid they will ruin their reputation in the community and everyone will laugh at them.

MR. SMITH: I might mention at this point that the Attorney General rendered an opinion on July 15, 1948 to the effect that a franchise that is sold for the purpose of raising money to manufacture and produce a particular article is not a security under the Corporate Securities Law so that leaves any remedy for the sale of a franchise under fraudulent representation or a false statement of facts solely upon the ground of bungo or theft. It has been our practice in recent years, and since this Attorney General's opinion has been rendered, to refer any complainants that do happen to wander into our office to the bungo squad, which is the District Attorney's Office.

ASSEMBLYMAN BRITSCHGI: I wanted to ask either you, Commissioner Sobieski, or Mr. Smith, do you have any background of any laws in other states that would be able to control the amount of franchise. I see nothing wrong in selling a franchise but I think the amount of the franchise is what we should be interested in. Do you know

of any laws that are in effect in other states that would control the amount of money involved in a franchise.

MR. SMITH: We don't know of any law in any other state. I might suggest that that would be a good question to be placed before the Legislative Counsel on behalf of the committee.

ASSEMBLYMAN HAWKINS: I assume that you have no authority to regulate franchises at the present time?

COMMISSIONER SOBIESKI: They are not securities, sir.

ASSEMBLYMAN HAWKINS: On the basis of that opinion, then, you have no authority whatsoever to regulate franchises.

COMMISSIONER SOBIESKI: Well if a person is selling stock and he would want to sell a franchise as a package with the sale of stock, in that limited area we would, but unless they have such a tiein with the sale of a security the answer is no.

ASSEMBLYMAN HAWKINS: At the present time the only way that any prosecutions can be obtained is through criminal law, is that right?

COMMISSIONER SOBIESKI: That is correct.

MR. THURN: Do you think it would help if you were given the authority to ask injunctive relief when you found that there was a situation where a person was using a franchise as a means of evading the Securities Exchange Act?

COMMISSIONER SOBIESKI: With the granted injunctive relief would be a proper measure provided that we had jurisdiction in the first place. In view of the Attorney General's opinion it is our view that legislation is required if we are going to regulate the sale of franchises for the purpose of promoting a new venture.

MR. THURN: Couldn't that injunctive relief be in the alternative? In other words either they would ask to cease and desist in the selling of these franchises or apply for a permit, that way getting around the opinion.

COMMISSIONER SOBIESKI: If there was a requirement that they secure a permit for the sale of franchises to promote a new venture then I think injunctive power would be a good tool to enforce that basic power but unless the basic control of it was granted to us I think the injunction wouldn't have anything to act on.

MR. THURN: Well you might have a well established business coming in from some other state that would be granting an exclusive franchise and would be well able to back up their commitments. There might be a great many of these. Would you want to be bothered with all of these various types of franchises that could be included in this?

COMMISSIONER SOBIESKI: I think the beginning certainly should be only in the promotional ventures.

ASSEMBLYMAN CHAPEL: Your contention is that any legislation which we introduce should be confined entirely to control the issue of sale of franchises purely in the promotional stage. Once they are really in business you don't believe we should touch them.

COMMISSIONER SOBIESKI: I think there is a sound basis for that distinction, sir, because where a business is going and is outstanding and working then another businessman can evaluate what the franchise is worth.

ASSEMBLYMAN CHAPEL: Well what I had in mind, I don't know

the details but I do remember that all of a sudden these Slenderella studios were closing up like morning glories at the end of the day. Now wasn't that a case of a lot of people buying a franchise from a going business which is past the promotional stage. In other words, I don't believe in too much government regulation. I don't think anybody here does either but I do think that sometimes we have to protect the fool from his own folly. Now there we've gone beyond your promotional stage at this point and I am interested in your thinking on this:

COMMISSIONER SOBIESKI: Slenderella has a great many separate corporations and separate entities, it is my understanding, at least, and I think those would have gone under the promotional umbrella.

ASSEMBLYMAN CHAPEL: Alright. Now, assume, for instance, that let's say Arthur Murray -- isn't it true when you open a Arthur Murray Dance Studio you buy a franchise from Arthur Murray?

COMMISSIONER SOBIESKI: I suppose so, I don't know.

ASSEMBLYMAN CHAPEL: Assume that the John Jones Dance Studio, we'll leave Arthur Murray out of it, is a going business and successful in many places, but assuming that the sale of these franchises, though it is not actually criminal fraud, they are sold to people who don't go to a lawyer or an accountant but they have a little money and they sell them on opening a dance studio. Do you think that the correct policy for this state would be to try to prevent suckers from buying these franchises?

COMMISSIONER SOBIESKI: Well I think the risk of danger to the public is greatest in the promotional area. We are blazing a new field and I would certainly recommend that we handle the promotional situation first before we go further.

ASSEMBLYMAN CHAPEL: In other words your mind is not closed to protect the fool from his own folly after the promotional deal is proved first.

COMMISSIONER SOBIESKI: That is right. I think that we can do a good job in the promotional field and then we ought to see how that works out before we extend it further.

ASSEMBLYMAN CHAPEL: Well that certainly sounds very sensible to me.

ASSEMBLYMAN CAMERON: Mr. Sobieski, could you very quickly outline how you would distinguish between a promotional franchise and a going concern franchise?

COMMISSIONER SOBIESKI: Well, you have put your finger on a good point, sir. Sometimes it is hard to draw the line but I think the line can be drawn and, for one thing, we could have an arbitrary rule with respect to if a company has been in business a specified length of time and has had income, not net income necessarily, but gross income from operations during that period of time, which income is earned from the type of operations that they propose to conduct.

ASSEMBLYMAN CAMERON: On this sort of a basis, wouldn't it be possible for me to be in the hamburger business in Newport Beach and have a going business and have been in business for ten years and I have a name which is catchy down in Newport Beach, I would qualify as having had the net income and the time of period I have been in business, etc., and then start selling franchises for this hamburger business in San Francisco, which would be of no real value. I don't see that the test in this case would be applicable. I am worried about the possibility of being able to

circumvent, relatively easily, this promotional situation. It seems to me that each time that a corporation issues a new block of securities they must come to you for a permit and I see no distinction between a franchise to do this particular function in another area then, in effect, a new flock of securities.

COMMISSIONER SOBIESKI: Well there is a lot of logic in that. I think, since we are starting out, we ought to confine ourselves to the things where the need is clearly the greatest and the case you put does indicate that if we limit it to promotional ventures that there will be a certain number which will be really promotions but not promotional in form. I think we are considering making a beginning and even though, on the first try, we don't get all that we should I think that we ought to get as many as we can.

CHAIRMAN CUNNINGHAM: Any other questions?

ASSEMBLYMAN CHAPEL: How much of a staff do you have to investigate these things?

COMMISSIONER SOBIESKI: Well I think we have around 275.

ASSEMBLYMAN CHAPEL: Do you mean you have 275 people that you can send out altogether to check on these things?

COMMISSIONER SOBIESKI: I doubt if I would but you asked how many would be available. We have other things to do, sir.

ASSEMBLYMAN CHAPEL: In other words, you have a competent staff and if we provide for a fee before they can issue a franchise then it would not particularly add to the burden that the state would have to provide.

COMMISSIONER SOBIESKI: If the fee schedule would simply say that they would pay the fee for the dollar amount of franchise it would be equivalent to a permit for the same dollar amount of stock.

That would more than cover the administrative cost.

MR. THURN: At the present time, Mr. Sobieski, if a corporation seeks to do business in this state they have to pay a franchise tax before they can enter into business, do they not?

COMMISSIONER SOBIESKI: I understand that, yes.

MR. THURN: Do these franchise sales now pay a tax?

COMMISSIONER SOBIESKI: No. Those are untaxed.

MR. THURN: Then franchise sales are not taxed but the corporations are. Is that right?

COMMISSIONER SOBIESKI: There is a distinction. The corporation pays a franchise tax and it also pays a fee if it wishes to sell securities. That fee covers the cost of our processing it and trying to protect the public in deciding whether it should or should not be sold. The sale of franchises are unregulated.

CHAIRMAN CUNNINGHAM: I believe that is all of the questions. Thank you very much, gentlemen. Our next witness is Mr. Thomas D. Hodge of the Los Angeles Better Business Bureau.

THOMAS D. HODGE, LOS ANGELES BETTER BUSINESS BUREAU: Mr. Chairman, our experiences in the Better Business Bureau of this City have not been extensive with respect to the type of franchise which is sold, say in lieu of stock, for the purpose of promoting a business. On the contrary we are constantly dealing with the promotional type of franchise.

There is the existing firm, corporation or individual who manufacturers or produces nothing for himself but will get an idea and have someone make models of that idea, if it is a product, and then go out on the market and try to get investors to invest in that product and, in turn, sell it at a higher price to the user

or to the consumer public. Our experiences are largely with this type. I mean the hideous experiences that we have are those fellows who advertise mostly under the heading of "business opportunities" and are purely promotional in their character. They will head their ads with such words as "own your own business", whereas nothing could be more manifest than the fact that the party to whom they are appealing to invest their money in the product or service being offered, is nothing more than a purchaser.

They also set forth such fanciful, unfounded, unwarranted representatives of earnings. For instance, invest \$499 in our product and earn \$1,000 a month or \$12,000 a year, or invest \$3,000 in our product and earn \$25,000 to \$40,000 a year. Believe me, that is lure to a lot of people, the get-rich-quick thinking people, and I am afraid some of the people who can least afford it do it. They have moderate means and maybe their life savings only but they fall for that type of advertising and in turn, they are gyped by the scores, by the hundreds, of concerns that are operating in the southern California area as well as by those from other states who make their offerings in California.

They use such phony phrases as "your investment is secured by inventory". To my judgment that is just the same thing as if I go down to one of the department stores and buy a hat and pay \$20 for it and they have got my \$20 when I go out of the store and I have got my hat and I wear it out and I don't know where there is any security in it. In other words a nominal situation of representing to the public that if you can have a security in your own property that you have bought and paid for.

They use such phrases as "nationally known". The fact is,

in many cases, as a matter of fact I have one that I am working on right now that is using the words in their advertising "nationally known". This is not only being advertised in California but in other states, but it is located in Los Angeles. They were organized on the 16th of November of this year. That is about two weeks ago and they are representing that if you invest \$2,300 in their product you will make a minimum of \$300 per week for the first 3 months and as high as \$5,000 per month throughout the balance of the investment.

Advertising is invariably blind as to the product or the service that they offer. In other words, somebody will be attracted by those alluring earning representations but have no idea of what the offer represents. They are blind as to their name. They do not give the name. They will give a box number of a newspaper or give a post office box wherever their residence is and that is just the way they want it. They want to get the fellow that is a potential sucker. They want to get to talk to him because all of these promotions are put on by clans of high pressure promotional salesmen. I think I could make a list of 150 of them in Los Angeles who are wonderful salesmen but they wouldn't work in legitimate businesses. They want a fast buck. As I say, you will find that the same men will appear out on the road peddling these franchise deals. He is is one, it folds up and he is in another, and so on, until, as I say, they are almost clannish.

Another thing that they put in their advertising is they will capitalize on the name of the manufacturer of a concern. Of course, a great many of them get the idea that some manufacturer has a good product and there is an appeal for it or with respect to it and they'll go to the manufacturer, whether it be here or elsewhere, some of the biggest companies we have, and they will make a contract

with them where, "if we buy so many of these from you what's the price". Alright, the manufacturer will sell, of course, on a quantity basis and at a discount price and do it very honorably, as far as the manufacturer is concerned, but then these fellows will immediately capitalize on the name of General Electric Company or Westinghouse Electric or a thousand other concerns. This is misleading the party to believe that he is really dealing with Westinghouse or General Electric or some other concern which is actually the manufacturer but which has nothing to do with that franchise salesman other than the fact that they are the supplier of the product.

I could give the committee a few of the things that are covered in this field. I am not overlooking some that were mentioned by Mr. Chairman, such as slenderizing, nursing schools and homework schemes. Now homework schemes are promotional franchises, in my judgment, with respect to slenderizing and these other reducing formulas and activities. Take slenderizing, if I recall the picture, they would grant a franchise in a given area and give some exclusive territory and there would be a separate corporation organized for each salon and the parent company of slenderizer would hold some amount of stock in the company. Now my recollection of it is that virtually every slenderizing company, except the parent company, went into bankruptcy in the southern district of New York City. Some of these studios just closed up and said there was just no use because they were losing money on it. The others I found, I think it affected one of our thrift and loan companies here who had bought too much of the slenderizing paper -- I think it is working itself out now, I don't know, but there was a thrift and

loan company that takes deposits from the public here that had bought a little too much of that paper, I am afraid.

We have toys, greeting cards, cosmetics, vending machines, oil additives, vitamin tablets, bet collection systems, that they sell to the small merchant or the professional man, etc., snack bars, fruit juice stands, lend-a-coins, paints, placards, diapers, television tubes, jewelry, household utensils, plastic items, vibrators and health equipment, dance studios, car washers, laundramats, perfumes, corn removers, cleaners and polishers, china and dinnerware, silverware, and various types of correspondence and training schools which I think I mentioned in connection with one of the nursing schools which, of course, are very dubious operations in most cases. If a man establishes a school in a given point then he will branch out by selling a franchise in some other area to some other person to run a school. Our experience is that the nurses and the graduates, if that is what they may be called because other types of schools really give no credit for it whatsoever insofar as registered nurse qualifications are concerned or a fellow teacher who has recognition in hospitals. There are also water softeners and conditioners, swimming pools and even mausoleums. We have people trying to sell franchises on mausoleums. As I say, it is almost endless as to the number of products.

Now when it comes to the operation, holding aside from the question of advertising, most of these promoters will operate, particularly if they are in Los Angeles, from a mail drop, a post office box or a telephone answering service and if they are from outside the state they will do the interviewing at a motel or in the lobby of some hotel. They invariably get all, if they can,

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but certainly most of the money, representing the franchise cost, at the time they sign up an agreement and they get a certified check or a cashier's check for fear the investing party will change his mind or investigate and stop payment on the check.

Now I don't mean to imply that every business opportunity that we see, and of course that is where most of the franchise deals of the promotional type are advertised, under business opportunities, that they are all wrong. They are not. Business opportunities can play a very fine place in business. For instance, if a man has a barber shop or a woman has a beauty salon, a cafe or a restaurant and if he wants to sell, it is something you can go and see. You can inventory it. You can look at the books and see what the business is. With those things we have no problem whatsoever.

ASSEMBLYMAN CHAPEL: You heard what the Commissioner of Corporations and his assistant had to say. They indicated that they thought that it was a good idea for us to introduce legislation regulating the sale of franchises in the promotional stage. You will remember that they were a little dubious about going any further at the present time. Now do you concur with what the Commissioner and his assistant said in their testimony.

MR. HODGE: Yes. I think the very first thing to

ASSEMBLYMAN CHAPEL: In other words, you would come up and testify if we had a bill in to regulate the sale of franchises that are in the promotional stage, to support this legislation yourself, would you not?

MR. HODGE: Yes, I would. I think there is a great need for this legislation.

ASSEMBLYMAN CHAPEL: I think we need a law. What do you do

for these people who complain to you, besides give them sympathy?

MR. HODGE: Well, of course, if we get a complaint which, on its face, has any degree of merit we process that against the business concern against whom the complaint is registered. We send them the original signed copy of the complaint.

ASSEMBLYMAN CHAPEL: Do you go to the District Attorney's Office?

MR. HODGE: We consult with all law enforcement agencies.

ASSEMBLYMAN CHAPEL: Do they nab any of these people?

MR. HODGE: Oh, yes.

ASSEMBLYMAN CHAPEL: Well I am glad to hear that.

MR. HODGE: We cooperate with every law enforcement agency in the state and in the federal government.

ASSEMBLYMAN CHAPEL: I am not questioning your operations. I am only trying to find out what happens under the existing law.

MR. HODGE: Well of course I ask you to keep in mind, sir, that the Better Business Bureau has no legal power or authority whatsoever. In other words, we cannot compel anyone to do anything or refrain from doing anything but when we get a series of complaints and are definitely convinced that an operation is a phony, we will take it up with anybody from the bunco squad of the police department on up and cooperate with them and give them the benefit of our files, complaints, etc.

ASSEMBLYMAN CHAPEL: Don't you find sometimes that people themselves that are running the phony operation that the first thing they do is to join the Better Business Bureau to give themselves a cloak of respectability. Have you ever found that?

MR. HODGE: We have had very few instances where they got in under misrepresentation but I think I could count them on one hand

in the last ten years. We wouldn't accept them for membership unless they have been in business for a year.

ASSEMBLYMAN CHAPEL: You do agree with the Commissioner then?

MR. HODGE: Yes, I do. I might say this to you. I think that half of the evil which results, I mean that victimize people in the types of deals which we are discussing, grow out of advertising and I would think that a lot could be accomplished by supplementation of existing statutes having to do with false advertising. My idea would be that if there was legislation which would specifically prohibit certain things by the advertiser, not the newspaper. In other words, if we had legislation, and of course false advertising is now covered by Section 17500 of the Business and Professions Code and following sections, it seems to me that we could make one step toward correcting a lot of abuses if we would compel an advertiser in the field of promotional franchises to name the product or service that he is offering to the public, to give his own name and his own address. That would be a wonderful help to every agency that is interested in this sort of thing, including all of your law enforcement agencies. If we would stop the person offering these franchises from saying, in effect, that he is the manufacturer, which invariably appears, when he manufacturers or produces nothing, but who is accepting the money from the parties who will never get anything back from it of any value. Those are some of the things that I think could be put in by simple amendments to existing statutes which would go far in correcting some of the abuses.

MR. THURN: Do you think the bunko laws are strong enough now so that once you do get hold of a person

MR. HODGE: Well, of course, when you say bunko laws you mean all of the criminal statutes?

MR. THURN: That's right.

MR. HODGE: No, I certainly do not think so.

MR. THURN: In other words, the damage is already done by the time they get into the picture.

MR. HODGE: That is right. I think we all have been talking, at least up until this time, about criminal prosecutions. What we are primarily interested in is to help the unwary fellow who falls for this thing. In other words, to prevent it, because all of our criminal prosecutions, even though they get convictions, isn't saving the man his money.

MR. THURN: An ordinary business opportunity broker is licensed, isn't he? In other words, one who advertises the sale of a business, a garage, or something like that?

MR. HODGE: Oh, yes. We have no problems with a business opportunity broker. We are talking about the wholly unlicensed individual who will get an idea and think the public will fall for it.

MR. THURN: Well he falls outside of the Business Opportunities Brokers Law now because he is selling something that belongs to himself. Is that right?

MR. HODGE: That is right. He is selling something in which he has a proprietary interest. He bought it and then wants to sell it at a higher price.

CHAIRMAN CUNNINGHAM: Any other questions by members of the committee. Thank you very much, Mr. Hodge.

The chair would like to acknowledge at this time the presence of Assemblyman Dills in the audience.

Our next witness will be Mrs. Frederick W. Spencer, representing

the California Federation of Women's Clubs and Mrs. Fred S. Teasley who is the State Radio and Television Chairman for the California Federation of Women's Clubs.

MRS. FREDERICK W. SPENCER, CALIFORNIA FEDERATION OF WOMEN'S CLUBS:

Mrs. Teasley is our State Chairman and if we may speak together it would be helpful and save the committee's time.

MRS. FRED S. TEASLEY, STATE RADIO AND TELEVISION CHAIRMAN,
CALIFORNIA FEDERATION OF WOMEN'S CLUBS: I thought that you would be discussing franchises for pay TV this morning. That is why I am here but I would like to make a statement about granting franchises for pay TV. This is also a new venture and although I realize that it hasn't been mentioned this morning I feel that there should be

CHAIRMAN CUNNINGHAM: I don't think, Mrs. Teasley, that we will take that up. I have promised other people in the audience that we wouldn't take up the subject of pay TV in any way this morning so they left.

MRS. TEASLEY: I see. We just wanted to go on record that we felt they should be regulated if they were granted.

MRS. SPENCER: I also came to this hearing because I thought the other subject was to be discussed but in listening to you this morning I would like to ask if, in formulating legislation relative to this handling of the sale of franchises, your legislation would cover not only the sale of promotional franchises but in some way assure the fact that franchises are sold to responsible people. There is not only the matter of the person who sells it but the person who receives it and uses it and it seems to me that both of those factors should be covered in the public interest and then the resale of franchises by someone who buys.

CHAIRMAN CUNNINGHAM: We are not sure at this time whether any legislation will result and we are certainly not sure

MRS. SPENCER: Well if it was, I wanted to point out that factor of not only the fraudulent sale but there could be legitimate sales but to a fraudulent person who would use it for fraudulent purposes and again, the public might be victimized.

ASSEMBLYMAN CHAPEL: You have raised two new points. The first is the investigation of the qualifications of the person buying the franchise and the second new point you raised, if I understand you correctly, is the possible resale.

MRS. SPENCER: Yes.

ASSEMBLYMAN CHAPEL: Well the resale would be covered under the same law as an original sale, if I understood what the Commissioner of Corporations had to say. Is that right, Mr. Thurn? Would you interpret that?

MR. THURN: I believe that would be right.

ASSEMBLYMAN CHAPEL: In other words, the resale would be taken care of in the same legislation that the Commissioner of Corporations said that we would be correct in introducing. So your second point would be taken care of if this legislation is introduced. Now your first point about the qualifications of the person to whom you sell the franchise. That goes into that matter of public policy that I raised in talking to the Commissioner. It is not an original expression of mine by any means. It's an old expression in the law of England and the United States "to protect the fool from his own folly". Now you are also introducing the element, aside from selling franchises to suckers, of selling franchises to people who would misuse them. Now you are getting into a field that I don't

understand how far you are going. I sympathize with you but we pass laws by the thousands and nobody enforces them. How could that be enforced? You are asking us to consider the qualifications of the person to whom the franchise is sold?

MRS. SPENCER: In the sense of the use of the franchise. I understand that you couldn't make an individual analysis of the people but when the franchise has been sold to them, and under that franchise they operate, would it be possible to assure that any operation under a franchise is legitimate and does not victimize the public.

ASSEMBLYMAN CHAPEL: You have gone a long ways now. We have to do one thing at a time. You have introduced a rather broad field there. You see, policing the operation of a franchise after it is sold is going into the criminal statutes, it is going into the Business and Professions Code and I don't quite follow how far you want to go.

MRS. SPENCER: Possibly it wouldn't be necessary to police it in the sense of following through after the sale and use of the franchise but if there were a law where it was shown that there were abuses then it would be possible to do something about it. In other words, if it were misused we would assume that some person would bring complaints. Well then, would there be a law under which a complaint could be followed through that would enforce a correction of such complaint.

ASSEMBLYMAN CHAPEL: You are going even further. You remember that the Commissioner told us to go a little slow and not monkey with laws on franchises sold by existing outfits but only during the promotional state. I think that what you are talking about is

the operation of the business after a franchise is sold. I think you are leading us into a very broad and difficult field. I don't quite follow how we are going to do all of this.

MRS. SPENCER: I would assume that the area of which I am thinking would be a likely supplement to the area that you speak of and which you are concerned with, that the promotional sale of franchises very likely might be followed up by business ventures, or business operations, that would not be in the public interest and which would victimize people. My thought was an extension of the main subject that you are talking about. At least, that was my intention.

ASSEMBLYMAN CHAPEL: Now you are hitting on a thing that some of the people thought I was kidding about before. Now these dance studios actually phone women in my district and say "you have just won a free course at Arthur Murray", or some other course, "will you come on down". The free course is for a few lessons but the hooker is that they sign them up and get some money out of them and they got a woman 85 years of age who could hardly walk and they got her down there and they signed her up for a dancing course and she had never danced in her life and the poor old lady fell down and broke her leg at the dance studio and then complained to me and I told her to get a lawyer and sue for damages which I think is just what she did. What I am getting at, you see what you are getting us in for in the conduct of these businesses after the franchise is sold. You would have people going around peeking through the windows of massage parlors, which would be a distinction, and policing dance and slenderizing studios and it would be impossible.

MRS. SPENCER: No, I wasn't speaking of that. I was speaking

of a law that would let it be handled if complaints came in.

ASSEMBLYMAN CHAPEL: Do you mean cancel the franchise?

MRS. SPENCER: Well, the law that you draw up, as far as you had planned to go, go enough farther so that abuses under a franchise could be followed through it complaints were made. Not that you would have enough staff to go around and police and follow up the franchises. Obviously, that is impossible, but have the law go far enough so that a complaining person could receive some relief under the law and that possible future abuses could be discontinued. For your information, Mr. Chapel, I have had many calls from the Arthur Murray Studios. I have won enough free courses, I think, to last a year if I had the time to go down.

MRS. TEASLEY: One of the things that I would like to say to you gentlemen is that when you hold these hearings I think it is necessary for you to have response from the people. I think that is what you want and that is why we are here this morning. I received a letter that the hearing was going to be held and I thought it would be on pay TV franchises also and that is why we were here but I would like to say that we realize the responsibility that you gentlemen have and we know you need response from us. We have learned a great deal being here this morning. It has been very interesting to us. I want you to know that we realize that leadership without response is like a general without an army so the Federation has responded to you this morning and would like to do so if you do hold more hearings along other lines.

CHAIRMAN CUNNINGHAM: I wish to thank you very much. We very seldom get a nice word and we certainly appreciate that and we are very happy that you are here in the formulation of this legislation

and we hope the Women's Clubs will help us and we would be glad to have your written comments at any time. Any further questions of these ladies? Mr. Thurn.

MR. THURN: I think what Mr. Chapel is referring to is we have a doctorate in law what they call caveat emptor which means let the buyer beware. Now that is still primarily the rule as far as the buyer and the seller are concerned, unless you have a warranty, either implied or expressed. An expressed one would be a guarantee, either oral or written or an implied one would be where you purchase a product and the product is implied to be fit for the purpose you purchase it for. Now do you think in these areas of slenderizing, dance studios and schools, and things of this nature, that this doctorate of caveat emptor should be set aside and the purchaser protected further?

MRS. SPENCER: It was my assumption that the purpose of government is to maintain law and order in the public interest and if the information relative to the nature of these businesses is not generally available to the individual person so that they may beware, or so that it is possible for them, reasonably easily, to know and protect themselves then I would assume that perhaps some little further action is necessary to make it easier for them to guard their own interests. The average person in private life does not have too much business knowledge or they may not know how to go about gaining special information relative to businesses and if they have a legitimate appearance on the surface, then I would certainly say that possibly they are not protected sufficiently. People who are active and exposed to information, such as has been

presented here this morning, may know how to go about inquiring and they may have the good judgment to inquire before they commit themselves but there are many people who have no idea of how to go about that. I think that women in organization work know a little more about those things than the average housewife and I would assume, from what has been said this morning, that there are a great many people, possibly women of an elderly nature, whose husbands have died, widows, or who have been left with a little property and are looking for some way to enhance it. Certainly those people, if they have not been exposed to business practices at all, would need to have a reasonable degree of protection from government and the law I would think.

CHAIRMAN CUNNINGHAM: Any other questions? Again I want to thank you very much for your complete cooperation.

We have a letter from the California Retailers Association that I will not read at this time but it will be placed in the record of transcript. (See Appendix I)

Since there are no further witnesses who wish to be heard I hear a motion from Mr. Chapel and a second from Mr. Britschgi that we do now adjourn. The meeting stands adjourned.

APPENDIX I

CALIFORNIA RETAILERS ASSOCIATION
Eleventh and L Building
Sacramento, California

Vincent D. Kennedy -- Managing Director

Sacramento
November 25, 1959

Honorable Rex M. Cunningham, Chairman
Assembly Interim Committee on Public
Utilities and Corporations
State Capitol
Sacramento 14, California

Dear Rex:

Prior commitments will keep both Vinc Kennedy and myself occupied on the date you will be holding hearings in Los Angeles on the use of franchises.

Due to our inability to be present we take this means of making known our views on the subject.

We are opposed to any legislation with plans to impose new regulations upon the retailer in connection with his use of franchised lines. Any legislation in the field would have an effect upon almost every retail store. We know of no abuses in this area and those we have queried without exception expressed satisfaction with the situation as it now stands.

A considerable portion of the retail sales are made in franchised lines. This is particularly true in the case of small specialty stores in men's and ladies ready-to-wear. Regulation by another state agency would bring hardship to the smaller operators who are not equipped to cope with new reports and regulations.

If you desire an elaboration of our views we will be pleased to submit additional information in the form of a written statement.

Sincerely,

s/ EMMONS MC CLUNG
Associate Managing Director